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No. 89-98

In the Supreme Court of the United States

OCTOBER TERM, 1989

HAROLD DAVIS AND ENID DAVIS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether amounts paid by petitioners directly to their children to cover their children's living expenses while they served as church missionaries are deductible by petitioners as charitable contributions under Section 170(a) of the Internal Revenue Code (26 U.S.C.).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a), as amended, is reported at 861 F.2d 558. The opinion of the district court (Pet. App. 16a-25a) is reported at 664 F. Supp. 468.

JURISDICTION

The judgment of the court of appeals was entered on November 14, 1988. A petition for rehearing was denied on April 20, 1989 (Pet. App. 27a). The petition for a writ of certiorari was filed on July 19, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioners and their sons, Benjamin and Cecil, are active members of the Church of Jesus Christ of Latter-Day Saints (the Church). The Church qualifies as an organization formed and operated for religious and charitable purposes within the meaning of Section 170 of the Internal Revenue Code,[1] which means that contributions "to or for the use of" the Church are tax-deductible. The Church operates a worldwide missionary program, in which more than 25,000 missionaries have participated annually since 1977. Pet. App. 2a, 5a.

In 1979, Benjamin Davis was chosen as a missionary by Church officials and notified that he would serve his duty at the Church's mission in New York City. The Church later provided Benjamin information relating to the New York Mission and advised him of the estimated amount of money that would be needed to support his missionary service. In October 1979, Benjamin was ordained as a missionary, and the next month he traveled to the New York Mission, where he served as a missionary until December 1981. Benjamin's brother, Cecil Davis, was chosen as a missionary in 1981 and assigned to the Church's New Zealand-Cook Island Mission. Cecil was also provided information by the Church regarding his mission and the approximate amount of money he would need for his expenses. In June 1981, Cecil was ordained as a missionary, and that August he reported to the New Zealand-Cook Island Mission for his service as a missionary. Pet. App. 17a-18a, 41a-43a.

During 1980 and 1981, while Benjamin was serving as a missionary in New York, petitioners transferred $3,481 and $4,135, respectively, to his personal checking account.

[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

He used these funds primarily to pay for his living expenses, *e.g.*, rent, food, transportation, and personal needs. A small portion of these funds was used to purchase religious materials utilized in his missionary work. During 1981, while Cecil was serving as a missionary, petitioners transferred $1,518 to Cecil's personal checking account. He used these funds to pay for his living expenses. Cecil did not expend any portion of the funds given to him on religious materials. Pet. App. 3a-4a.

Benjamin and Cecil Davis were not required to seek specific Church approval of expenditures made from their personal checking accounts. Each week, however, they submitted a report to their Mission President and Zone Leader, which included, *inter alia*, a listing of the total expenses for the week and for the month to date. They were not required to turn over to the Church any funds in their personal accounts that remained at the end of their missions (Pet. App. 9a). Cecil had no such remaining funds; Benjamin purchased a camera with his remaining funds shortly before he terminated his mission. *Id.* at 3a-4a, 42a-44a.

2. Petitioners timely filed their joint federal income tax returns for 1980 and 1981. On these returns, petitioners claimed Benjamin and Cecil as dependents and did not claim a charitable contribution deduction for the amounts paid to them for their living expenses incurred during their missionary service. In 1984, petitioners filed amended income tax returns, claiming deductible charitable contributions of $3,480 and $4,882 for the support payments made to their sons. The Internal Revenue Service disallowed the refund claims based on these claimed deductions, and petitioners then instituted this refund

suit in the United States District Court for the District of Idaho. Pet. App. 18a, 44a-45a.[2]

The district court granted summary judgment for the government (Pet. App. 16a-25a). The court held that the payments made by petitioners to their sons were not made "to or for the use of" a qualified charity within the meaning of Section 170(a) of the Code and hence were not deductible by the parents. The court explained that a donation that is not made directly to a charitable organization is deductible as being "for the use" of that organization only "when the charity has sufficient possession of the contribution so that it has discretion as to the use to which the donated funds will be put" (Pet. App 24a). The court found that this test was not met here because "[t]he particular use to which the funds were put was solely within the power of the missionary" (*ibid.*). The court added that, apart from providing a "projected budget range," "there is no indication that the church was involved in any way in controlling how the missionary's money was spent" (*ibid.*).

3. The court of appeals affirmed (Pet. App. 1a-15a). The court ruled that, in order for a charitable contribution to be deductible, the recipient charity must have control over the donated funds, so as to ensure that the payment benefits the charity and not a particular individual (*id.* at 9a). In so concluding, the court relied in part on a line of cases holding that taxpayers are not permitted to deduct payments to charities that are earmarked for the benefit of

[2] On their 1984 amended returns, petitioners claimed charitable contributions for amounts in excess of the amount of living expenses that had been estimated by the Church in the letters sent to Benjamin and Cecil concerning their missions. In September 1986, after the refund suit was filed, petitioners filed a second set of amended returns, on which they reduced the amount of their charitable deductions to correspond to the amount specified in the letters and also reduced the number of dependents claimed. Pet. App. 18a, 45a.

particular individuals (*id.* at 7a-8a). The court determined that the funds deposited directly into petitioners' sons' checking accounts did not meet this "control" test, noting that, "[w]hile the Church admonished the missionaries to spend their money wisely, the particular use to which the funds were put was solely within the control of the missionaries" (*id.* at 9a).[3] The court acknowledged that its decision is inconsistent with *Brinley* v. *Commissioner*, 782 F.2d 1326 (5th Cir. 1986), and *White* v. *United States*, 725 F.2d 1269 (10th Cir. 1984), but concluded that those cases were incorrectly decided. See Pet. App. 8a-9a, 11a-13a.

ARGUMENT

The court of appeals correctly held that the payments made by petitioners to support their children during their period of missionary service were not deductible as charitable contributions under Section 170(a) of the Code. We agree with petitioners, however, that the decision below squarely conflicts with the decisions of two other courts of appeals. Moreover, resolution of this conflict is important to the fair and evenhanded administration of the tax laws. Accordingly, we do not oppose the grant of certiorari in this case.

1. Section 170(a) of the Code allows a taxpayer to take an income tax deduction for a "charitable contribution" paid within the taxable year. Section 170(c)(2)(B) includes

[3] Like the district court (see Pet. App. 20a-22a), the court of appeals also rejected petitioners' contention that funds paid to their sons could be deducted as "unreimbursed expenses" incurred incident to the rendition of charitable services within the meaning of Treas. Reg. § 1.170A-1(g) (26 C.F.R.) (*reprinted at* Pet. App. 19a-20a). The court explained that the regulation permits the deduction only of unreimbursed expenses incurred by the person actually rendering charitable services. Pet. App. 10a-14a.

within the definition of "charitable contribution" any contribution or gift "to or for the use of" an organization formed and operated exclusively for religious or charitable purposes. The standard governing the deductibility of amounts claimed as charitable contributions thus has two basic components: one relating to the nature of the payment and the other relating to the nature of the recipient. First, the payment must qualify as a "contribution" or "gift," which excludes payments made with the expectation of a commensurate financial return or quid pro quo. See generally *Hernandez* v. *Commissioner,* 109 S. Ct. 2136, 2143-2144 (1989). Second, the "contribution" or "gift" must be made "to or for the use of" a qualified recipient. See generally 8 J. Mertens, *Law of Federal Income Taxation* § 31.01, at 4-7 (1987); 2 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 35.1.1 (1981).[4] The issue of statutory construction presented in this case concerns the second component of the inquiry: if we assume that petitioners' payments were "contribution[s] or gift[s]", the question is whether they were made "to or for the use of" the Church within the meaning of Section 170(c).

The court of appeals correctly concluded that petitioners' payments to their children were not made "to or for the use" of the Church because the Church "lacked actual control over the funds" (Pet. App. 9a). In situations where a taxpayer has claimed a charitable contribution for funds paid to a charitable organization but earmarked for

[4] Section 170 also places other limitations on the deductibility of payments claimed as charitable contributions. To be deductible, the payment must be made within the taxable year (§ 170(a)(1)), and consist of cash or qualified property (§ 170(e)-(h)) that does not exceed a specified percentage of the taxpayer's income in the year of payment or (where a carryover is permitted) in subsequent years (§ 170(b) and (d)). See *Hernandez* v. *Commissioner,* 109 S. Ct. at 2143 n.6.

a specific individual, the Internal Revenue Service has focused on whether the charity exercises control over the donated funds and has discretion as to their use. See, *e.g.,* Rev. Rul. 62-113, 1962-2 C.B. 10. As noted by the court of appeals, the lower courts generally have embraced this analysis.[5] Petitioners err in asserting (Pet. 12) that this analysis "eviscerates the statutory language"; the control requirement is fully consistent with the text of Section 170. If an organization has no control over certain funds, it cannot "use" them in the ordinary sense of the word. Similarly, if funds are transferred to an individual under circumstances that will not provide an organization with control over their disposition, the funds would not ordinarily be regarded as having been given "for the use of" that organization.[6]

This limitation serves two important and related purposes. First, requiring that the funds be placed within the

[5] See, *e.g., Winn* v. *Commissioner,* 595 F.2d 1060, 1065 (5th Cir. 1979); *Tripp* v. *Commissioner,* 337 F.2d 432, 435, 436 (7th Cir. 1964); *Morey* v. *Riddell,* 205 F. Supp. 918, 921 (S.D. Cal. 1962); *Peace* v. *Commissioner,* 43 T.C. 1, 7-8 (1964). See generally Note, *Does Charity Begin at Home? The Tax Status of a Payment to an Individual as a Charitable Deduction,* 83 Mich. L. Rev. 1428, 1431-1433 (1985).

[6] The legislative history of the Revenue Act of 1921, ch. 136, § 214(a)(11), 42 Stat. 241, which added the phrase "for the use of," discloses that Congress added this phrase for a specific purpose—namely, to overrule a Treasury decision that had denied a deduction for a payment made directly to a trust company for eventual disbursement for charitable purposes. See 61 Cong. Rec. 5294 (1921) (statement of Rep. Green); *Revenue Act of 1921: Hearings Before the Senate Comm. on Finance,* 67th Cong., 1st Sess. 523-526, 530-531 (1921). Thus, the phrase was intended to cover the situation where a payment is made to a nonqualifying corporation to be held in trust for a charitable corporation, with the funds eventually to be disbursed to the charitable corporation. The exceedingly broad reading that petitioners would give to the words "for the use of" goes far beyond Congress's intent and clearly is not necessary to avoid rendering those words superfluous.

control of a qualified recipient serves to ensure that the gift will be used for charitable purposes—which is the premise upon which Congress has determined that such gifts should be tax-deductible. See Rev. Rul. 62-113, *supra*. Second, the control requirement is vital to the ability of the IRS to perform its oversight responsibilities in the charitable contribution area. So long as contributions are deductible only if they are placed within the control of a qualified recipient, the IRS can seek to confirm whether such contributions are actually being used for charitable purposes by examining the activities of a limited number of prequalified charitable recipients. If payments to individuals were to be deductible even where a qualified recipient has no control over the disposition of the funds, however, the IRS could monitor compliance only by auditing a massive number of individual taxpayers.[7] See *Brinley* v. *Commissioner*, 782 F.2d at 1338 (Hill, J., dissenting).

2. Although we believe that the court of appeals correctly rejected petitioners' contentions, we agree with petitioners that there exists a conflict in the circuits on the question presented that warrants the attention of this Court. Two other courts of appeals have held, on essentially identical facts, that payments made by parents to support their missionary children can be deducted as charitable contributions under Section 170. In *White* v. *United States*, *supra*, the Tenth Circuit explicitly rejected the "control" requirement that has been applied by the Commissioner and held that the payments in question

[7] In the context of this case, the difference is between conducting an audit of the Church, in which various items can be spot-checked to determine if funds within the Church's control are being spent for charitable purposes, and auditing each of the 25,000 Church missionaries and their relatives in order to determine whether particular gifts were used for charitable purposes.

were deductible because they were made for the "primary purpose [of] further[ing] the aims" of the Church. See 725 F.2d at 1271-1272. In *Brinley* v. *Commissioner*, *supra*, the Fifth Circuit declined to adopt the "primary purpose" analysis applied by the court of appeals in *White*. The Fifth Circuit, however, reversed the unanimous reviewed decision of the Tax Court that had upheld the Commissioner's denial of the claimed deductions (82 T.C. 932 (1984)), and remanded the case for further proceedings to determine whether the deductions should be allowed under a formulation of the control test different from that applied by the Commissioner and the Tax Court. The court held that the control requirement could be satisfied if the taxpayers showed that the amounts paid to support their children matched a specific request from the Church for those amounts. 782 F.2d at 1335-1336. The court of appeals here, in denying the claimed deductions, specifically rejected the holdings of both of these other courts of appeals. See Pet. App. 8a-9a.

Resolution of this conflict is of considerable administrative importance. Petitioners state (Pet. 2) that the Church has more than 25,000 missionaries from the United States serving worldwide. To the extent the parents of these missionaries provide direct financial support for their children's missionary activities, the issue presented in this case will govern the tax liability of many United States taxpayers. Moreover, the general issue presented here has ramifications beyond the specific context of the Church's missionary program. Accordingly, we do not oppose the grant of certiorari.

CONCLUSION

The petition for a writ of certiorari should be granted.
Respectfully submitted.

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